> having done one or more of the following: ... (5) conditioned the license of any rights to the patent or the sale of the patented product on the acquisition of a license to rights in another patent or purchase of a separate product, unless, in view of the circumstances, the patent owner has market power in the relevant market for the patent or patented product on which the license or sale is conditioned.

STATEMENT OF THE CASE

This case presents the important question of whether tying patents together in package licenses is subject to the well-established *per se* rule against tying arrangements.[2] This Court has applied the *per se* rule under patent misuse doctrine and antitrust law to a wide variety of tying arrangements, including tying of intellectual property in package licenses. *See, e.g., United States v. Loew's*, 371 U.S. 38, 44-51 (1962); *United States v. Paramount Pictures, Inc.*, 334 U.S. 131, 156-59 (1948). However, in this case, the Federal Circuit distinguished *Paramount* and *Loew's* on their facts and created an exception to this Court's general rule. The Federal Circuit found that even though U.S. Philips Corporation ("Philips") had market power and

---

[2] The term "*per se*" as used herein does *not* mean 'unlawful without inquiry into market power,' as this term was recently used by the Court in *Illinois Tool Works Inc. v. Independent Ink, Inc.*, 126 S.Ct. 1281, 547 U.S. --- (2006). The term "*per se*" is used herein as it was used below, to describe a test of illegality that requires proof of market power, following the requirements of *Jefferson Parish Hospital Dist. No. 2 v. Hyde*, 466 U.S. 2, 12-18 (1984) and 35 U.S.C. § 271(d)(5). Thus, the use of the term "*per se*" here is consistent with the holding in *Illinois Tool Works* that market power will not be presumed from the existence of a patent, but rather must be proven. *See* 126 S.Ct. at 1293. The so-called "*per se*" test discussed herein, involving proof of a tying arrangement and market power, stands in contradistinction to the "rule of reason" test, involving fact-intensive weighing of procompetitive and anticompetitive effects.

actually tied patents together in mandatory, non-negotiable package licenses, these licenses were exempt from the general *per se* rule against tying because patents should be treated differently. App. 2a-24a.

The Federal Circuit's decision conflicts with this Court's precedent and alters the balance between patent rights and freedom of competition. The Department of Justice ("DOJ") and Federal Trade Commission ("FTC") have highlighted the importance of balancing patent rights and antitrust principles by issuing their Antitrust Guidelines for the Licensing of Intellectual Property (Apr. 6, 1995), http://www.usdoj.gov/atr/public/guidelines/0558.pdf (hereinafter Guidelines), and holding extensive hearings. *See To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy*, A Report by the FTC at 1-3 (Oct. 2003), http://www.ftc.gov/os/2003/10/innovationrpt.pdf. By creating a special exception for patent-to-patent tying, the Federal Circuit contravened the Guidelines' basic tenet that patents should be treated like any other property under antitrust principles and are not particularly free from scrutiny. Guidelines §2.1.

Thus, the Federal Circuit not only discarded the consistency, predictability, and administrative convenience of the *per se* rule, but also exposed technology and innovation markets to the "unacceptable risk of stifling competition."[3] *Jefferson Parish*, 466 U.S. at 9. The court gave patent owners a special ability to exploit their rights in ways other property holders cannot, to the detriment of competition. A patent owner having market power by virtue of patents on a core technology can tie these patents with patents on peripheral or follow-on technologies, stifling competitors who would compete with alternative peripheral

---

[3] For definitions of technology and innovation markets, *see* Guidelines §§3.2.2-3.3.3.

or follow-on technologies, without invoking the *per se* rule. By tying these patents together, the patent owner can also thus insulate the individual patents from attack and create a substantial barrier to entry. It can even pool its patents with other patent owners to form powerful patent pools that exploit one party's market power. Given that tying of all other tangible and intangible property is subject to the *per se* rule, it is inconsistent and imprudent to hinge protection of competition in technology and innovation markets on judges and juries' ability to weigh complex expert testimony about economic effects. *Arizona v. Maricopa County Medical Society*, 457 U.S. 332, 343 (1984) ("Judges often lack the expert understanding of industrial market structures and behavior to determine with any confidence a practice's effect on competition."). Holding patent-to-patent tying subject only to rule of reason analysis means that such anticompetitive conduct is less likely to be challenged and, when challenged, is apt to be condoned in many cases.[4]

This Court should grant review to consider whether patent-to-patent tying should receive such forgiving treatment. This case raises the issue of the appropriate contours of the *per se* rule against tying in an important modern context given the proliferation of patent pools. Philips's package licenses at issue have provoked scrutiny around the world. The Taiwan Fair Trade Commission ("Taiwan FTC") held Philips's pools with other patent

---

[4] *See also, e.g.*, Frank H. Easterbrook, *Allocating Antitrust Decisionmaking Tasks*, 76 Geo. L.J. 305, 305 (1987) (evaluating practices under the rule of reason "as a practical matter meant that they were declared lawful per se, although the attorneys' fees incurred on the way to the ritual absolution were a hefty tax on the lawful conduct"); Richard A. Posner, *The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision*, 45 U. Chi. L. Rev. 1, 14 (1977) ("[T]he content of the Rule of Reason is largely unknown; in practice, it is little more than a euphemism for nonliability.").

owners violated Taiwanese competition law, and the European Commission recently closed its inquiry into the licenses upon Philips's agreement to revise its licensing practices, noting its intention to monitor patent pools closely. App. 117a-118a, 317a-318a. This Court has not addressed package licensing of intellectual property since *Loew's* over 40 years ago and has not considered the basic contours of the *per se* rule against tying since *Jefferson Parish* over 20 years ago. This issue is ripe for review, especially since the Federal Circuit has exclusive jurisdiction over patent cases. Patent-to-patent tying allegations are most likely to arise as antitrust counterclaims or a patent misuse defense, effectively making the Federal Circuit's decision the law of the land if it is not reviewed by this Court.

A. The Mandatory Package Licenses At Issue

Philips owns patents on technology for recordable compact discs ("CD-Rs") and rewritable compact discs ("CD-RWs"). App. 2a. Sony Corporation ("Sony") and Taiyo Yuden Co. Ltd. ("Taiyo Yuden") also own patents on CD-R technology, while Sony and Ricoh Co., Ltd. ("Ricoh") also own patents on CD-RW technology. App. 3a, 113a. Technical standards for the manufacture of CD-Rs and CD-RWs are set forth in a publication called the Recordable CD Standard, known as the "Orange Book," which was jointly authored by Philips and Sony. App. 2a.

In the early 1990s, Philips, Sony, and Taiyo Yuden pooled their patents on CD-R technology to license them jointly as a mandatory, non-negotiable package. App. 2a-3a, 113a. This joint package originally included 45 U.S. patents and numerous foreign patents. App. 114a. Similarly, Philips, Sony, and Ricoh pooled their patents on CD-RW technology to license them jointly as a package. App. 3a, 113a. Philips was authorized to administer these joint package licenses by the other members. App. 209a. Philips did not allow licensing of the patents individually, permit a

lower royalty rate for licensing fewer than all the patents in a package, or vary the royalty rate depending on which patents were used. App. 2a-3a.

In 2001, the Taiwan FTC ruled the joint package licenses violated Taiwanese competition law. App. 117a. In response to the Taiwan FTC's investigation and decision, Philips and the other licensors were required for the first time to begin offering separate package licenses containing only their own patents. App. 255a-256a. Now that licensees could bargain directly with each licensor, they obtained a lower total royalty on CD-Rs by signing separate licenses. App. 256a-259a. One reason for this was that Sony had no relevant patents in Taiwan and therefore could not continue to collect a royalty in Taiwan from Taiwanese manufacturers, such as Petitioners. App. 258a-260a.

In any event, there are still licensees operating under the joint package licenses. App. 213a. Approximately 80% of Philips's licensees worldwide are licensed under the joint package licenses, while the other 20% are licensed under the separate package licenses containing only Philips's patents. App. 217a. Consequently, there are four package licenses at issue here: (1) a joint CD-R package license; (2) a joint CD-RW package license; (3) a CD-R package license containing only Philips's patents; and (4) a CD-RW package license containing only Philips's patents.[5] These licenses require licensing all patents Philips identifies as "essential" to manufacture discs compliant with the Orange Book standard and include patents identified as "non-essential." App. 3a. Petitioners and Philips dispute whether certain patents Philips has identified as "essential" are truly essential.

---

[5] Each license is relevant as a potential basis for patent misuse, since all were in effect during the Commission's investigation, and Philips did not try to show it had purged the alleged misuse. App. 104a.

B. The ALJ's Opinion

While the ALJ held Petitioners infringed Philips's patents, the ALJ held them unenforceable based on patent misuse.[6] App. 4a. The ALJ found that Philips's package licenses constituted patent misuse *per se* and under the rule of reason as impermissible tying arrangements, in addition to finding misuse on other grounds. App. 39a-40a. The ALJ observed that 35 U.S.C. § 271(d)(5) required proof of market power to find patent misuse based on tying and, after a detailed analysis, found that Philips had market power. App. 131a-151a. The ALJ found that the licenses constituted impermissible tying arrangements because they tied "essential" patents (the tying items) to "non-essential" patents (the tied items). "Essential" patents were defined as "technically essential" or "essential as a practical matter" to manufacture Orange-Book compliant discs, while "non-essential" patents were not essential for this purpose. App. 162a.

The ALJ explained that tying non-essential patents to essential patents disadvantaged existing or emerging alternative technologies which could compete with technologies covered by the non-essential patents. App. 162a. Since licensees had to pay the same royalty regardless of whether they used the non-essential patents, they had little, if any, incentive to license alternative technologies, which blocked opportunities for such alternative technologies to emerge. App. 234a. While Philips began having the licenses reviewed in 2001, years after they went into effect, by an "independent evaluator" to determine which patents were essential, he applied an excessively liberal standard for "essentiality." App. 163a, 168a, 234a. The ALJ explained this standard "suppresse[d] emerging technologies by gradually extending the reach of the pools

---

[6] The Commission had jurisdiction under 19 U.S.C. § 1337(a)(1)(B).

beyond the Orange Book like a creeping vine," citing the DOJ's Business Review Letters on patent pools. App. 168a. The ALJ found a dozen Philips, Sony, Taiyo Yuden and Ricoh patents in the package licenses were not in fact essential to manufacturing Orange Book-compliant discs.

In alternatively finding patent misuse under the rule of reason, the ALJ concluded that the anticompetitive effects of Philips's package licenses outweighed the alleged procompetitive effects. App. 194a-200a. The ALJ noted a dramatic anticompetitive effect was the enormous drop in the royalty that occurred after the Taiwan FTC ruled Philips's joint package licenses illegal. App. 196a.

C. The Commission's Opinion

The Commission affirmed that Philips committed patent misuse *per se* and under the rule of reason because its licenses constituted impermissible tying arrangements. App. 39a-40a. The Commission did not take a position on the findings of misuse on other grounds.[7] App. 40a.

The Commission looked to this Court's *per se* rule against tying as set forth in, *e.g.*, *Jefferson Parish*, and in particular the application of the rule to package licensing in *Paramount*. App. 49a-50a. The Commission concluded that applying the rule of those cases to patent-to-patent tying in a package license was "a reasonable application of Supreme Court precedent."[8] App. 50a. Relying on this Court's explanation of the fundamental harm of tying arrangements

---

[7] For efficiency reasons, the Commission can take no position on cumulative grounds for finding no violation of 19 U.S.C. §1337. *See Beloit Corp. v. Valmet Oy*, 742 F.2d 1421, 1423 (Fed. Cir. 1984).

[8] Philips argued that, since the DOJ and FTC stated that they would apply rule of reason analysis to tying arrangements in the exercise of their prosecutorial discretion, that the Commission should abandon the *per se* test. App. 50a. The Commission noted that the DOJ and FTC's decision to apply their prosecutorial discretion did not undermine the validity of the *per se* approach. App. 51a.

in *Jefferson Parish*, 466 U.S. at 13 n.19, the Commission explained that the harm of tying patents in a package license was the suppression of technologies which would otherwise compete with patented technologies included in the license. App. 53a-54a. The Commission noted that licensors could easily avoid the *per se* rule: "All that is necessary is to provide potential licensees with a backstop – the choice of individually licensing the patents; there is nothing wrong with offering the package license as an option, rather than as a requirement." App. 52a-53a.

The Commission held that, to prove patent misuse *per se* premised on a tying arrangement, Petitioners needed to establish that Philips had market power, that the "tying" and "tied" patents in the package license were "separate" products, and that these "separate" products were in fact tied together. App. 61a. The Commission adopted the ALJ's finding that Philips had market power. App. 64a-66a. The Commission found that the patents Philips called "essential" were in fact tied together because potential licensees could not license them individually, but rather had to license the whole package. App. 66a-76a. The Commission also found that four of the patents which Philips called "essential" were actually not essential because manufacturers could produce Orange Book-compliant discs without using them, and therefore these "non-essential" patents were separate products from the truly essential patents. App. 76a-89a.

Since Petitioners met each element of the test set forth by the Commission, the Commission found patent misuse *per se*. App. 89a. In addition, the Commission found misuse under the rule of reason, adopting the ALJ's weighing of the anticompetitive and procompetitive effects. App. 89a-105a.

D. The Federal Circuit's Opinion

Before proceeding to the heart of its analysis, the Federal Circuit dismissed Philips's argument that it was shielded by §271(d)(5) because it lacked market power. The court

sustained the Commission's finding that Philips had market power. App. 10a. The court also held that Philips had in fact tied patents together in its package licenses. App. 3a.

The heart of the Federal Circuit's opinion was that, even though Philips had market power, its patent-to-patent tying in package licenses could not constitute patent misuse *per se*. App. 12a-24a. The court acknowledged that it is "hornbook law" that mandatory package licensing constitutes misuse. App. 12a. The Federal Circuit also recognized that this Court had found "block-booking," in which licenses to show copyrighted films were licensed exclusively in blocks of multiple films, were *per se* illegal in *Paramount Pictures*, 334 U.S. at 156-59, and *Loew's*, 371 U.S. at 44-51. App. 12a-13a. However, it deemed patents to be different and held these cases were inapplicable to patent-to-patent tying. App. 13a-16a.

The Federal Circuit distinguished *Paramount* because it believed that case's rationale rested on a requirement that licensees exhibit all the films in the blocks they licensed:

> Because the block-booking arrangement at issue in *Paramount* required the licensee to exhibit all of the films in the group for which a license was taken, the *Paramount* block-booking was more akin to a tying arrangement in which a patent license is tied to the purchase of a separate product, rather than to an arrangement in which a patent license is tied to another patent license. ... Because the arrangement in the *Paramount* case was equivalent in substance to a patent-to-product tying arrangement, *Paramount* does not stand for the proposition that a pure patent-to-patent tying arrangement, such as Philips's package licensing agreement, is per se unlawful.

App. 14a. The court concluded, "Because Philips's package licensing agreements do not compel the licensees to use any particular technology covered by any of the licensed patents,

the *Paramount* case is not a sound basis from which to conclude that the package licensing arrangements at issue in this case constitute patent misuse per se." App. 15a. The court also distinguished *Loew's*, contending that case rested on the price of the block of films being raised due to the tying and finding no evidence of such a price increase in Philips's licenses. App. 15a-16a.

The Federal Circuit delved into a policy-based analysis to support its holding that, due to "important differences between product-to-patent tying arrangements and arrangements involving group licensing of patents," patent-to-patent tying is not subject to the *per se* rule applied to product-to-patent tying. App. 16a-24a. While the court conceded that a package license could have the effect "that the customer will choose not to license the alternative technology offered by the patentee's competition," it reasoned that competitors were not harmed because licensees were not compelled to use the technologies covered by the non-essential patents. App. 18a. The court analogized the package licenses to an arrangement it believed was clearly benign – a licensor's charging a royalty for essential patents and licensing non-essential patents for free. App. 21a. The court also found that package licenses reduce transaction costs and provide certainty. App. 22a-24a. While the Commission had pointed out that *per se* treatment could be avoided if the patents were also licensed individually, the court dismissed the need for individual licensing. App. 19a-21a. The court assumed that the Commission's point rested on an unstated assumption that individual licenses would be less expensive and did not address the safeguard against foreclosure of competition that individual licensing would offer. App. 19a-21a.

Having decided patent-to-patent ties were not subject to the *per se* rule generally applied to tying arrangements, the Federal Circuit then appeared to craft a new, higher standard for determining whether there are separate products. As

applied by the Federal Circuit, this standard demands not only proof of an existing alternative technology and that a potential licensee wanted to license less than the entire package, but also that the licensee specifically made a request to the licensor, and that this request was refused. App. 27a-28a. The Federal Circuit also deemed the Commission's rule of reason analysis flawed, reversing and remanding the case for further proceedings.[9] App. 31a-35a.

REASONS FOR GRANTING THE PETITION

The Federal Circuit's holding that patent-to-patent tying is exempt from the *per se* rule against tying conflicts with this Court's long history of applying this rule to a wide variety of tying arrangements, including those involving intellectual property. *See Loew's*, 371 U.S. at 44-51; *Paramount*, 334 U.S. at 156-59. While this Court's recent tying cases have focused on the need to show market power, Philips's market power is well-established, and its package licenses should have been condemned under the *per se* rule. The Federal Circuit improperly confined *Paramount* and *Loew's* to their facts in refusing to apply their holding that mandatory packaging licensing of intellectual property is *per se* illegal to mandatory package licensing of patents.

Moreover, this case is exceptionally important because it requires striking the proper balance between two principal legal forces underlying the nation's economic growth, patent rights and competition policy. The Federal Circuit has elevated patent rights over freedom of competition, sweeping aside this Court's precedent and the DOJ's concerns about package licensing of patent pools, and dismissing the safeguards that the DOJ emphasized. This unique forgiving

---

[9] There is also a parallel district court case where Petitioners' patent misuse defense will proceed in view of the Federal Circuit's decision in the present case. *See U.S. Philips Corp. v. Princo Corp.*, 361 F. Supp. 2d 168 (S.D.N.Y.), *rev'd and remanded*, 424 F.3d 1179 (Fed. Cir. 2005).

treatment of patents conflicts with the DOJ and FTC's judgment, and the recommendation of leading scholars, that patents should receive the same treatment as other property under the antitrust laws.

This case offers an opportunity for this Court to provide guidance on how the *per se* rule should apply in the important modern context of patent commercialization, as well as an avenue to revisit the basic contours of the rule itself. Several Justices expressed interest in delving into the rule at oral argument in *Illinois Tool Works*, and this case provides an excellent vehicle to achieve this objective.

I. THE FEDERAL CIRCUIT'S DECISION CONFLICTS WITH DECISIONS OF THIS COURT, OTHER CIRCUIT COURTS, AND CONGRESS

This Court has long applied a *per se* rule against tying in a wide variety of contexts, including cases involving patents and tying of intellectual property rights. *See Jefferson Parish*, 466 U.S. at 18-29 (tying services of anesthesiologists to hospital services); *United States Steel Corp. v. Fortner Enterprises, Inc.* (*Fortner II*), 429 U.S. 610, 611 (1977) (tying of credit to purchase of a prefabricated house); *Loew's*, 371 U.S. at 46 (tying copyrighted films to other copyrighted films); *Paramount*, 334 U.S. at 145-46 (tying copyrighted films to other copyrighted films); *International Salt Co. v. United States*, 332 U.S. 392, 395-96 (1947) (tying salt to leases of patented salt machines). This Court has consistently applied the rule regardless of the nature of the items being tied together.

Circuit courts have applied this Court's rule to the particular tying arrangement at issue here, patent-to-patent tying in package licenses. *See International Manufacturing Co. v. Landon, Inc.*, 336 F.2d 723, 731 (9th Cir. 1964) (applying the rule but finding a lack of separate products because all patents were essential); *American Securit Co. v. Shatterproof Glass Corp.*, 268 F.2d 769, 775-78 (3rd Cir.

1959) (finding patent misuse); *Duplan Corp. v. Deering Milliken, Inc.*, 444 F. Supp. 648, 696-97 (D.S.C. 1977) (finding patent misuse), *aff'd in part and rev'd in part*, 594 F.2d 979, 981 (4th Cir. 1979) (affirming the district court's "explicit and sound" decision, except for holding two more parties liable).

In the past thirty years, this Court added a requirement of market power in the tying product. *See Jefferson Parish*, 466 U.S. at 13-16; *Fortner II*, 429 U.S. at 622. Earlier this year, this Court clarified that the need to prove market power applies equally to tying arrangements involving patents. *See Illinois Tool Works*, 126 S.Ct. at 1284. Thus, this Court brought the standards of proof for tying arrangements involving patents into harmony with those for all other tying arrangements. This Court acknowledged that proof of market power serves the gate keeping function of admitting only those tying arrangements which are likely to harm competition. *See id.* at 1287-88. Consequently, this Court confirmed that its older precedent on tying arrangements remains applicable, as long as market power is proven:

> [W]e conclude that tying arrangements involving patented products should be evaluated under the standards applied in cases like *Fortner II* and *Jefferson Parish* rather than under the *per se* rule applied in *Morton Salt* and *Loew's*. While some such arrangements are still unlawful, such as those that are the product of a true monopoly or a marketwide conspiracy, *see, e.g.* [*Paramount*], that conclusion must be supported by proof of power in the relevant market rather than by a mere presumption thereof.

Id. at 1291.

When Congress amended the Patent Act in 1988, it merely brought patent misuse doctrine into line with the proof of market power requirement set forth in *Jefferson Parish*. *See* 35 U.S.C. §271(d)(5). Congress chose not to

create any special exception from patent misuse or antitrust law for patents.

Here, the Federal Circuit affirmed the finding that Philips had market power in the relevant market, App. 10a, giving Philips a special ability to harm competition. *See Illinois Tool Works*, 126 S.Ct. at 1287-88 (quoting *Jefferson Parish*, 466 U.S. at 13-16). However, the Federal Circuit decided to create a special exception from this Court's *per se* rule against tying, which Congress had left intact. It was not the Federal Circuit's role to go farther than the statute Congress enacted and refuse to apply this Court's *per se* rule. *See Jefferson Parish*, 466 U.S. at 32 (Brennan, J., concurring) ("Congress, presumably aware of our decisions, has never changed the rule by amending the Act. In such circumstances, our practice usually has been to stand by a settled statutory interpretation and leave the task of modifying the statute's reach to Congress.")

The Federal Circuit's decision directly conflicts with this Court's basic holding in two cases that tying intellectual property together in mandatory package licenses is *per se* illegal. *See Loew's*, 371 U.S. at 50; *Paramount*, 334 U.S. at 159. The court in effect limited *Paramount* and *Loew's* to their facts by holding that mandatory package licensing of patents is exempt from the *per se* rule. In reaching this decision, the Federal Circuit usurped this Court's prerogative of deciding whether to overrule its own decisions. *See Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484 (1989) ("[T]he Court of Appeals should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions"). The Federal Circuit's decision is particularly troubling because, in this Court's last case addressing the contours of the *per se* rule against tying, this Court expressly affirmed the vitality of the rule. *See, e.g., Jefferson Parish*, 466 U.S. at 9 ("It is far too late in the history of our antitrust jurisprudence to question the proposition that certain tying arrangements pose

an unacceptable risk of stifling competition and therefore are unreasonable 'per se.'").

The Federal Circuit distinguished *Paramount* based on a minor factual difference that did not underlie its holding. The holding in *Paramount* is unmistakable: "All we hold to be illegal is a refusal to license one or more copyrights unless another copyright is accepted." 334 U.S. at 159. This Court reasoned that conditioning a license to copyrights on some films on accepting a license to others increases the market for some films because the appeal of certain films drives acceptance of the package. *See id.* at 158. Neither this Court's holding nor its reasoning rested on, or even mentioned, whether licensees must exhibit the films which they licensed.

However, the Federal Circuit refused to apply the holding that tying one intellectual property right to another is illegal because it believed that the holding in *Paramount* rested on licensees being required to exhibit the films. To support this erroneous interpretation, the Federal Circuit relied on a single sentence in dicta describing the District Court's holding, not this Court's holding. App. 13a. This Court described the District Court's holding: "*The District Court* (66 F. Supp. 349) *held* it illegal for that reason and for the reason that it '*adds to the monopoly of a single copyrighted picture that of another copyrighted picture which must be taken and exhibited in order to secure the first.*'" 334 U.S. at 157 (emphasis added). But, when the Federal Circuit quoted from this sentence, it omitted the first few words attributing this holding to the District Court, and incorrectly attributed this holding to this Court: "*The Court held* that block-booking was illegal because it 'prevents competitors from bidding for single features on their individual merits,' and because it '*adds to the monopoly of a single copyrighted picture that of another copyrighted picture which must be taken and exhibited in order to secure*

the first.'" App. 13a (quoting *Paramount*, 334 U.S. at 156-57) (emphasis added).[10]

In rationalizing its abandonment of the *per se* rule, the Federal Circuit also contravened this Court's instructions in *Paramount*. The Federal Circuit viewed the convenience of only offering a package license and its usefulness in ensuring Philips full value for its patents as justifications for its licensing practices. App. 21a. The court also credited benefits (*e.g.*, reducing transaction costs and avoiding litigation), which would have still existed if Philips had also licensed the patents individually, while at the same time dismissing this safeguard as an improper expectation. App. 21a-24a. In contrast to the Federal Circuit's reasoning, this Court had instructed that application of the *per se* rule does not depend on the convenience of the tying party but rather on whether licensees are required to take the entire package:

> Columbia Pictures makes an earnest argument that enforcement of the restriction as to block-booking will be very disadvantageous to it and will greatly impair its ability to operate profitably. But the policy of the anti-trust laws is not qualified or conditioned by the convenience of those whose conduct is regulated. ...
>
> We do not suggest that films may not be sold in blocks or groups, when there is no requirement, express or implied, for the purchase of more than one film. All we hold to be illegal is a refusal to license

---

[10] It is highly questionable whether even the District Court's decision rested on a requirement to exhibit the films because the District Court stated twice that its holding rested only on conditioning one license on acceptance of another, not any requirement to exhibit the films. *See United States v. Paramount Pictures, Inc.*, 66 F. Supp. 323, 348, 350 (S.D.N.Y. 1946), *aff'd in part and rev'd in part*, 334 U.S. 131 (1948).

> one or more copyrights unless another copyright is accepted.

Paramount, 334 U.S. at 159.

To distinguish *Loew's*, the Federal Circuit relied on a sentence fragment about an issue entirely distinct from the basic holding in *Loew's* that tying intellectual property rights together is illegal. In *Loew's*, this Court again held a party cannot tie intellectual property rights together. This Court explained the "flat holding" in *Paramount* that "a refusal to license one or more copyrights unless another copyright is accepted is illegal" applied because *Paramount* "ha[s] general application to tying arrangements" and its holding was "but a particularized application of the general doctrine." 371 U.S. at 50. Rather than apply this holding, the Federal Circuit improperly distinguished *Loew's* by claiming that this Court found an illegal tie because a "substantial portion of the licensing fees represented the cost of the inferior films which the stations were required to accept." App. 15a. The Federal Circuit's reliance on this sentence fragment was misplaced because it related to the issue of market power, not the basic holding that tying intellectual property rights together is illegal. The sentence fragment appeared in a list of illustrative examples to justify presuming market power from the existence of a copyright. *See* 371 U.S. at 49. Since the sentence fragment cited by the Federal Circuit addressed the issue of market power, it could not justify the court's abandoning the basic holding that tying intellectual property rights together is unlawful.

The Federal Circuit's distinction of *Loew's* was also premised on a misunderstanding of the facts of *Loew's* and the present case. The court considered Philips's tying arrangements more benign than those in *Loew's* because it believed the movie distributors in *Loew's* extracted a supracompetitive royalty by virtue of their tying arrangements, while it believed Philips did not do so. App.

15a-16a. The Federal Circuit had the facts reversed. As this Court noted in *Illinois Tool Works*, there was "evidence of significant competition in the market for the tying product" in *Loew's*, and therefore it is unlikely that the movie distributors could have extracted a supracompetitive royalty. 126 S.Ct. at 1286. By contrast, here the joint package CD-R license was a tool for collusion to extract a supracompetitive royalty. When Philips, Sony, and Taiyo Yuden were forced to begin licensing their own CD-R patents separately in response to the Taiwan FTC investigation, the total of the royalties they could obtain on their own was lower than the royalty that they extracted by pooling their patents together in the joint package CD-R license. App. 256a-259a.

Furthermore, the Federal Circuit's improper distinctions of this Court's cases to avoid applying their basic holding that tying intellectual property rights together is illegal effectively scuttles the *per se* rule. This Court has repeatedly recognized the value of adhering to *per se* rules due to the importance of consistency and predictability, and the difficulty of judicial inquiry into economic effects. *See Federal Trade Commission v. Superior Court Trial Lawyers Assoc.*, 493 U.S. 411, 430-35 (1990); *Jefferson Parish*, 466 U.S. at 13 n.16; *Arizona v. Maricopa County Medical Society*, 457 U.S. at 349-51; *United States v. Topco Associates, Inc.*, 405 U.S. 596, 610 n.10 (1972) ("Without the per se rules, businessmen would be left with little to aid them in predicting in any particular case what courts will find to be legal and illegal under the Sherman Act").[11] But a rule ceases to be a rule at all, and the benefits of having a rule are lost, when its application becomes dependent on facts peripheral to the nucleus of facts which invoke the rule.

---

[11] *See also* Antonin Scalia, *The Rule of Law as a Law of Rules*, 56 U. Chi. L. Rev. 1175 (1989) (explaining the value of legal rules, particularly in the field of antitrust law).

Indeed, revisiting *Paramount* and *Loew's* under the Federal Circuit's view of their *ratio decidendi* illustrates the violence that the court has done to the *per se* rule. Under the court's reasoning, movie distributors having market power need not fear the *per se* rule if they resume block-booking their copyrighted films. They must merely take care not to require theaters to exhibit the films, which would be superfluous in any event since movie theaters will naturally show the films. The court has plainly limited these cases to their facts, nullifying their holding that packaging licensing of intellectual property is illegal. Indeed, under the Federal Circuit's reasoning, movie distributors having market power can even pool their copyrighted films together in a "super block" and charge more for this "super block" than they could collect by block-booking on their own. In fact, they can charge almost any price for this "super block" because theaters are locked in – they must show movies – and must try to pass along the cost to consumers as best they can. These are precisely the approaches Philips took to licensing its patents in joint package licenses with Sony, Taiyo Yuden and Ricoh, and later in package licenses including only its own patents.

In sum, by limiting *Paramount* and *Loew's* to their facts, the Federal Circuit minted an exception that creates a gaping hole for anticompetitive behavior.[12] The court insulated tying arrangements involving intellectual property, which inherently provides the powerful right to exclude competition, from equal treatment under this Court's *per se* rule protecting freedom of competition.

---

[12] District courts have begun applying this exception. *See Globespanvirata, Inc. v. Texas Instruments, Inc.*, No. 03-2854, 2006 WL 543155 at *7-9 (D.N.J. Mar. 3, 2006) ("The Federal Circuit Court of Appeals held that a patent-to-patent tying arrangement is not *per se* unlawful. ... While certain types of tying arrangements may remain *per se* unlawful, patent-to-patent tying cases do not fall into that category.")

II. THE PROPER BALANCE BETWEEN PATENT RIGHTS AND FREEDOM OF COMPETITION IS EXCEPTIONALLY IMPORTANT TO THE NATION'S ECONOMY AND THE FEDERAL CIRCUIT'S DECISION ALTERS THE BALANCE

The application of the rules protecting free competition to patent rights, which is at the core of this case, is exceptionally important to the nation's economy. The DOJ and FTC's joint issuance of their Antitrust Guidelines for the Licensing of Intellectual Property evidences the importance of this issue. Their subsequent joint Hearings on Competition and Intellectual Property Law and Policy in the Knowledge Based Economy, involving over 300 panelists and over 100 written submissions, also testifies to its prominence. *See To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy*, A Report by the Federal Trade Commission at 3 (Oct. 2003), http://www.ftc.gov/os/2003/10/innovationrpt.pdf. In its Executive Summary of the hearings (*id.* at 1), the FTC explained that patents and competition policy stand out in driving economic growth, emphasizing the need for a proper balance between them:

> An economy's capacity for invention and innovation helps drive its economic growth and the degree to which standards of living increase. ...
> Competition and patents stand out among the federal policies that influence innovation. Both competition and patent policy can foster innovation, but each requires a proper balance with the other to do so. Errors or systematic biases in how one policy's rules are interpreted and applied can harm the other policy's effectiveness.

The Federal Circuit has injudiciously tipped the balance in favor of patent rights, finding that patents qualify for a special exception from the established *per se* rule against

tying. This policy decision conflicts with a basic principle of the DOJ and FTC's enforcement policy and the recommendation of leading scholars. The first of the three general principles underlying the Guidelines is, "for the purpose of antitrust analysis, the Agencies regard intellectual property as being essentially comparable to any other form of property." Guidelines §2.0. Directly contrary to this principle of equal treatment for intellectual property, the Federal Circuit held that a "fundamental difference" between patents and products makes patent-to-patent tying less suspect and exempt from the *per se* rule applicable to tying of all other tangible and intangible property. App. 16a. By contrast, the DOJ and FTC have instructed that intellectual property is no less suspect under the antitrust laws than other forms of property and that there is no fundamental difference which would justify abandoning the application of standard antitrust principles:

> The Agencies apply the same general antitrust principles to conduct involving intellectual property that they apply to conduct involving any other form of tangible or intangible property. That is not to say that intellectual property is in all respects the same as any other form of property. Intellectual property has important characteristics .... These characteristics can be taken into account by standard antitrust analysis, however, and do not require the application of fundamentally different principles.
>
> ***
>
> ... Intellectual property is thus neither particularly free from scrutiny under the antitrust laws, nor particularly suspect under them.

Guidelines §2.1. Leading antitrust scholars have similarly recommended that patents should be treated the same as other property. *See* 10 Philip E. Areeda, Herbert Hovenkamp, & Einer Elhauge, Antitrust Law ¶1780b (2nd

ed. 2004) ("[W]e recommend that antitrust law should generally treat patents and related practices in the same way it treats conduct involving other kinds of property.").

By creating an exception to the *per se* rule against tying for patents, the Federal Circuit has improvidently undermined "the Magna Carta of free enterprise." *Topco*, 405 U.S. at 610 ("Antitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise. They are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms."). The Federal Circuit's decision comes at a time when there is a call for antitrust to "take a bolder position in areas of potential conflict with IP [intellectual property] law than it has in the past." *See* Herbert J. Hovenkamp, "United States Antitrust Policy in an Age of IP Expansion" (January 4, 2005), *Berkeley Center for Law and Technology, Law and Technology Scholarship (selected by the Berkeley Center for Law & Technology)*, Paper 2, Abstract, http://repositories.cdlib.org/bclt/lts/2.

In addition, striking the proper balance between antitrust and intellectual property law is becoming increasingly important as patent pools proliferate. *See* Hearings on Competition and Intellectual Property Law and Policy in the Knowledge Based Economy, Cross-Licensing and Patent Pools, DOJ and FTC at 11-12 (Apr. 17, 2002), http://www.ftc.gov/opp/intellect/020417trans.pdf (opening remarks of Robert Potter, Chief, Legal Policy Section, DOJ's Antitrust Division) ("With the increasing number of patents we are seeing increasing numbers of cross-licensing arrangements and patent pools."). The Taiwan FTC's ruling that Philips's joint package licenses are illegal and the European Commission's inquiry, which resulted in changes to Philips's licensing practices, show the scrutiny they have provoked around the world. App. 117a-118a, 317a-318a.

The Federal Circuit ignored or rejected the main threats posed by Philips's package licenses and dismissed the safeguards which the DOJ had emphasized in approving other patent pools. As explained by the DOJ, innovators of "essential" (*i.e.*, basic) technology are entitled to their reward for that technology but are not entitled to disadvantage competition in "non-essential" (*e.g.*, follow-on) technologies. *See* DOJ, Business Review Letter at 10-11 (Dec. 16, 1998), http://www.usdoj.gov/atr/public/busreview/2121.htm (hereinafter DVD Ltr.). In addressing Philips's patent pool about manufacturing DVD-ROM discs, the DOJ considered technology for packaging these discs as an example of "non-essential" technology. *See id.* The DOJ explained that, if a patent on one packaging method were included in the pool, it would disadvantage competitors trying to license patents on other packaging methods because manufacturers would be less inclined to license another method in addition to the one included in the pool:

> Consider, for example, a situation where there are several patented methods for placing DVD-ROMs into packaging -- each a useful complement to DVD-ROM manufacturing technology, but not essential to the standard. A DVD-ROM maker needs to license only one of them; they are substitutes for each other. ... Inclusion in the pool of one of the patents, which the pool would convey along with the essential patents, could in certain cases unreasonably foreclose the competing patents from use by manufacturers; because the manufacturers would obtain a license to the one patent with the pool, they might choose not to license any of the competing patents, even if they otherwise would regard the competitive patents as superior. Limiting a pool to essential patents ensures that neither of these concerns will arise; rivalry is

> foreclosed neither among patents within the pool nor between patents in the pool and patents outside it.

Id.[13]

However, the Federal Circuit rejected the point that inclusion of non-essential patents would harm competition. App. 17a-18a. The court made the basic mistake of concluding that, since a patent owner can charge any royalty it wishes for an essential patent, it can wield the power of its patents in any other way without causing more damage to competition. App. 18a-22a. *See* Louis Kaplow, *Extension of Monopoly Power Through Leverage*, 85 Colum. L. Rev. 515, 515-16 (1985) ("The basic mistake in [the "Chicago School's"] central thesis is that antitrust law should be indifferent to the exploitation of monopoly power because extant power is a fixed sum and thus will result in the same damage regardless of how it is deployed.").[14]

The Federal Circuit also ignored the point that patent pooling insulates patents from challenges since they draw strength from each other and do not stand on their own merits. *See* William M. Landes & Richard A. Posner, The Economic Structure Of Intellectual Property Law 383 (2003) ("The most troubling aspect of patent pooling and cross-licensing from an antitrust standpoint is that it discourages

---

[13] *See also* DOJ, Business Review Letter at 9-10 (June 26, 1997), http://www.usdoj.gov/atr/public/busreview/1170.htm (hereinafter MPEG Ltr.) ("The limitation of the Portfolio to technically essential patents, as opposed to merely advantageous ones, helps ensure that ... the Portfolio license does not, by bundling in non-essential patents, foreclose competitive implementation options that the MPEG-2 standard has expressly left open.") (hereinafter MPEG Ltr.).

[14] To illustrate the point, Professor Kaplow analogizes a firm with a fixed sum of market power to a terrorist with one stick of dynamite who can place it anywhere, explaining, "It is all too obvious, however, that the potential damage resulting from power in this context, as well as in virtually any other we can imagine, is overwhelmingly dependent upon how it may be used." *Id.* at 516.

challenges to the validity of particular patents."); Hearings on Competition and Intellectual Property Law and Policy in the Knowledge Based Economy, Cross-Licensing and Patent Pools, DOJ and FTC at 193 (Apr. 17, 2002), http://www.ftc.gov/opp/intellect/020417trans.pdf (remarks of M. Howard Morse, Partner, Drinker, Biddle & Reath, LLP) ("[T]here is a concern that the combining patents of uncertain scope and validity strengthens all of the patents in the pool since a challenger only needs to lose on one patent to be enjoined."). Indeed, Philips's joint package licenses enabled Philips to tie together the thicket of its own patents with the patent thickets of others, creating an impenetrable wall of patents and eviscerating licensees' bargaining power.

Having ignored or rejected the harms of Philips's package licenses, the Federal Circuit rendered the safeguards that the DOJ had emphasized in approving Philips's other patent pools legally inconsequential. The court's decision effectively means that licensees will no longer need to follow the DOJ's admonitions. The DOJ emphasized use of an independent expert from the start of the patent pool to ensure non-essential patents were not included, to protect competition: "The limitation of the Portfolio to technically essential patents and the use of an independent expert to be the arbiter of that limitation reduces the risk that the patent pool will be used to eliminate rivalry between potentially competing technologies." MPEG Ltr. at 15. Although the DOJ gave Philips this admonition in 1997, Philips did not begin having its expert evaluate essentiality until 2001, the year before Philips sued Petitioners. App. 234a. When the evaluation finally began, the number of U.S. patents Philips deemed "essential" in the joint CD-R package license dropped from 44 to 11, App. 214a, and Petitioners proved the existence of alternative technology to patents Philips continued to deem "essential," App. 27a-28a. Despite this evidence, the court exempted the licenses from the *per se*

rule and found these facts insufficient to constitute misuse under its forgiving analysis. App. 12a-31a.

The DOJ had also noted that "the independent availability of each Portfolio patent is a valuable failsafe," MPEG Ltr. at 11, but the Federal Circuit similarly dismissed this safeguard. App. 19a-21a.

Under the Federal Circuit's decision, patent owners can tie their patents together, regardless of whether they are essential, and only license them as a package – and even extract a higher total royalty than they could achieve on their own – without implicating the *per se* rule. According to the court, even if an alternative technology is identified – which was an especially difficult feat here given that Philips's licensing practices have been foreclosing competition since the early 1990's – this does not invoke the *per se* rule. Indeed, by requiring evidence that a potential licensee actually confronted the licensor about using a commercially viable alternative technology (App. 28a), the court effectively rewards the more successful tie-in, since such evidence will be nearly impossible to find where competition has been entirely foreclosed. The Federal Circuit has made the DOJ's admonitions a relic and opened a gaping hole for anticompetitive behavior because it will be almost impossible to prove patent-to-patent tying unlawful. *See* Daniel P. Homiller, *Patent Misuse in Patent Pool Licensing: From National Harrow to "The Nine No-Nos" to Not Likely*, 2006 Duke L. & Tech Rev. 7, ¶¶ 29-38 (2006) (recognizing that the Federal Circuit has discarded the DOJ's safeguards and explaining the fallacy in the Federal Circuit's reasoning from an economic perspective); Robin C. Feldman, *Defensive Leveraging in Antitrust*, 87 Geo. L.J. 2079, 2112 (1999) (Commenting, "Common wisdom holds that a lawsuit will fail unless the plaintiff can avoid the rule of reason analysis and obtain per se treatment," and proposing a new structured test for tying arrangements based on analysis of

the harms of leveraging); *Easterbrook*, *supra* note 3; *Posner*, *supra* note 3.

III. THIS CASE IS AN EXCELLENT VEHICLE TO ADDRESS TYING DOCTRINE IN A MODERN CONTEXT

This case offers the opportunity to address tying doctrine in an important context in our modern, knowledge-based economy: patent-to-patent tying in package licensing of patent pools. The Court has not considered the basic contours of its *per se* rule against tying since it decided *Jefferson Parish* over 20 years ago. It has been much longer – over 40 years – since the Court last addressed package licensing of intellectual property in *Loew's*, and that case did not involve a technology or innovation market. Although the Court recently revisited tying doctrine in *Illinois Tool Works*, the Court's decision answered only the narrow question before it: whether market power should be presumed from the existence of a patent under antitrust law in tying cases. *See* 126 S.Ct. at 1284. The Court's answer clarified the burden of proof required to satisfy the rule against tying in a particular class of cases, finally closing a loophole which had long since been closed in patent misuse law and Government enforcement policies. *See id.* at 1290-93. However, the Court did not "undertake a fresh examination," *id.* at 1285, of the far more significant questions: In view of the Court's precedent, what ought to be the general test for unlawful tying? Further, should tying of intellectual property, particularly patents, be subject to this general test? These questions are squarely presented here.

This case provides an excellent vehicle to address these questions because, unlike all the Court's cases in the past 30

years involving tying, market power has been proven.[15] The ALJ found Philips had market power in the relevant market based on a detailed analysis that was adopted by the Commission, and the Federal Circuit easily dismissed Philips's feeble challenge to this finding. App. 10a-11a. The crux of this case is whether package licenses of patents should receive more lenient treatment than the established *per se* rule affords, either because they are a special exception (as the Federal Circuit found), or because the rule itself should be changed. It is important that the Court address these issues.[16]

Several Justices expressed interest in addressing the basic contours of tying doctrine at oral argument in *Illinois Tool Works*. Justice Stevens's questions to Petitioners, as well as Justices Breyer and Scalia's questions to Respondent, suggested interest in going beyond addressing the presumption of market power to consider the economics of the rule itself. *See* Transcript of Oral Argument at 18-19, 32-34, 51, *Illinois Tool Works*, 126 S.Ct. 1281 (No. 04-1329). Chief Justice Roberts specifically asked the Government for its position on whether tying "still presents an antitrust problem," assuming there is market power in the tying product. *Id.* at 27. The Government did not take a position on the issue, since it was not presented in that case, leading

---

[15] See *Illinois Tool Works*, 126 S.Ct. at 1293; *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 467-78 (1992); *Jefferson Parish*, 466 U.S. at 26-29; *Fortner II*, 429 U.S. at 617-22.

[16] Hearings on Competition and Intellectual Property Law and Policy in the Knowledge Based Economy, Analysis of Specific Licensing Practices, DOJ and FTC at 30-31 (May 14, 2002), http://www.ftc.gov/opp/intellect/020514trans.pdf (remarks of Jonathan M. Jacobson, Partner, Akin, Gump, Strauss, Hauer & Feld, LLP) ("[W]hen the client asks you about what the rules are governing bundling of intellectual property ... you cannot give a clear answer. ... [T]he best solution would be for the Supreme Court to address a case involving tying, involving intellectual property tying in particular, and deal with these issues once and for all.").

Justice Stevens to reiterate his interest and inquire where the Court is headed in this area. *See id.* at 30. The case at hand squarely presents these issues of interest to the Court, and the Court (and the Government) should take this opportunity to address them.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

ALAN D. SMITH
CHARLES H. SANDERS
Counsel of Record
FISH & RICHARDSON P.C.
225 FRANKLIN STREET
Boston, MA 02110-2804
(617) 542-5070

Counsel for Petitioners

Supreme Court, U.S.
FILED
051341 APR 19 2006
OFFICE OF THE CLERK

No.

IN THE

Supreme Court of the United States

PRINCO CORPORATION, PRINCO AMERICA CORPORATION, GIGASTORAGE CORPORATION TAIWAN, GIGASTORAGE CORPORATION USA, AND LINBERG ENTERPRISE INC.,

Petitioners,

v.

U.S. PHILIPS CORPORATION,

Respondent.

On Petition for Writ of Certiorari To The United States Court Of Appeals For The Federal Circuit

APPENDIX

ALAN D. SMITH
CHARLES H. SANDERS
Counsel of Record
FISH & RICHARDSON P.C.
225 FRANKLIN STREET
BOSTON, MA 02110
(617) 542-5070

Counsel for Petitioners

TABLE OF CONTENTS

U.S. Court of Appeals for the Federal Circuit's Opinion.....1a

U.S. International Trade Commission's Opinion.....36a

Administrative Law Judge's Opinion 106a

U.S. Court of Appeals for the Federal Circuit's Order Denying Rehearing En Banc.....315a

European Union Press Release: Competition: Commission closes investigation following changes to Philips CD-Recordable Disc Patent Licensing 317a

**United States Court of Appeals,
Federal Circuit.**

**U.S. PHILIPS CORPORATION, Appellant,
v.
INTERNATIONAL TRADE COMMISSION,
Appellee,
and
Princo Corporation, Princo America Corporation,
Gigastorage Corporation Taiwan,
Gigastorage Corporation USA, and Linberg
Enterprise Inc., Intervenors.**

No. 04-1361.

**Sept. 21, 2005.
Rehearing En Banc Denied Dec. 19, 2005.**

Clara Kuehn, Attorney, Office of General Counsel, United States International Trade Commission, of Washington, DC, argued for appellee. With her on the brief were James M. Lyons, Acting General Counsel, and Wayne W. Herrington, Acting Deputy General Counsel for Litigation.

Alan D. Smith, Fish & Richardson P.C., of Boston, Massachusetts, argued for intervenors. With him on the brief were Charles H. Sanders of Boston, Massachusetts; and Richard G. Green and Tina M. Chappell, of Washington, DC. Of counsel was Ahmed J. Davis, of Washington, DC.

***1182** John DeQ. Briggs, III, Howrey Simon Arnold & White, LLP, of Washington, DC, for amicus curiae Intellectual Property Owners Association. With him on the brief were Marc G. Schildkraut and Joseph P. Lavelle. Of counsel on the brief was J. Jeffrey Hawley, President,

Intellectual Property Owners Association, of Washington, DC.

David F. Ryan, Fitzpatrick, Cella, Harper & Scinto, of New York, New York, for amicus curiae New York Intellectual Property Law Association. With him on the brief was Matthew S. Seidner. Of counsel on the brief was John D. Murnane, President, New York Intellectual Property Law Association, of New York, New York. Of counsel was Joseph B. Divinagracia.

Before BRYSON, GAJARSA, and LINN, Circuit Judges.

BRYSON, Circuit Judge.

U.S. Philips Corporation appeals from a final order of the United States International Trade Commission, in which the Commission held six of Philips's patents for the manufacture of compact discs to be unenforceable because of patent misuse. The Commission ruled that Philips had employed an impermissible tying arrangement because it required prospective licensees to license packages of patents rather than allowing them to choose which individual patents they wished to license and making the licensing fee correspond to the particular patents designated by the licensees. *In re Certain Recordable Compact Discs & Rewritable Compact Discs,* Inv. No. 337-TA-474 (Int'l Trade Comm'n Mar. 25, 2004). We reverse and remand.

I

Philips owns patents to technology for manufacturing recordable compact discs ("CD-Rs") and rewritable compact discs ("CD-RWs") in accordance with the technical standards set forth in a publication called the Recordable CD Standard (the "Orange Book"), jointly authored by Philips and Sony Corporation. Since the 1990s, Philips has been licensing those patents through package licenses. Philips

specified that the same royalty was due for each disc manufactured by the licensee using patents included in the package, regardless of how many of the patents were used. Potential licensees who sought to license patents to the technology for manufacturing CD-Rs or CD-RWs were not allowed to license those patents individually and were not offered a lower royalty rate for licenses to fewer than all the patents in a package.

Initially, Philips offered four different pools of patents for licensing: (1) a joint CD-R patent pool that included patents owned by Philips and two other companies (Sony and Taiyo Yuden); (2) a joint CD-RW patent pool that included patents owned by Philips and two other companies (Sony and Ricoh); (3) a CD-R patent pool that included only patents owned by Philips; and (4) a CD-RW patent pool that included only patents owned by Philips. After 2001, Philips offered additional package options by grouping its patents into two categories, which Philips denominated "essential" and "nonessential" for producing compact discs compliant with the technical standards set forth in the Orange Book.

In the late 1990s, Philips entered into package licensing agreements with Princo Corporation and Princo America Corporation (collectively, "Princo"); GigaStorage Corporation Taiwan and GigaStorage Corporation USA (collectively, "GigaStorage"); and Linberg Enterprise Inc. ("Linberg"). Soon after entering into the agreements, however, Princo, GigaStorage, and Linberg stopped paying the licensing fees. Philips filed a complaint with the International Trade Commission that Princo, GigaStorage, ***1183** and Linberg, among others, were violating section 337(a)(1)(B) of the Tariff Act of 1930, 19 U.S.C. § 1337(a)(1)(B), by importing into the United States certain CD-Rs and CD-RWs that infringed six of Philips's patents.

The Commission instituted an investigation and identified 19 respondents, including GigaStorage and Linberg. Additional respondents, including Princo, were added through intervention. In the course of the proceedings before an administrative law judge, the respondents raised patent misuse as an affirmative defense, alleging that Philips had improperly forced them, as a condition of licensing patents that were necessary to manufacture CD-Rs or CD-RWs, to take licenses to other patents that were not necessary to manufacture those products. In particular, the respondents argued that a number of the patents that Philips had included in the category of "essential" patents were actually not essential for manufacturing compact discs compliant with the Orange Book standards, because there were commercially viable alternative methods of manufacturing CD-Rs and CD-RWs that did not require the use of the technology covered by those patents. The allegedly nonessential patents included U.S. Patent Nos. 5,001,692 ("the Farla patent"), 5,740,149 ("the Iwasaki patent"), Re. 34,719 ("the Yamamoto patent"), and 5,060,219 ("the Lokhoff patent").

The administrative law judge ruled that the intervenors had infringed various claims of the six asserted Philips patents. The administrative law judge further ruled, however, that all six of the asserted patents were unenforceable by reason of patent misuse. Among the grounds invoked by the administrative law judge for finding patent misuse was his conclusion that the package licensing arrangements constituted tying arrangements that were illegal under analogous antitrust law principles and thus rendered the subject patents unenforceable.

Philips petitioned the Commission for review of the administrative law judge's decision. In an order that addressed only the findings concerning patent misuse, the

Commission affirmed the administrative law judge's ruling that Philips's package licensing practice "constitutes patent misuse per se as a tying arrangement between (1) licenses to patents that are essential to manufacture CD-Rs or CD-RWs according to Orange Book standards and (2) licenses to other patents that are not essential to that activity." The Commission found that the Farla, Iwasaki, Yamamoto, and Lokhoff patents were not essential to manufacturing CD-Rs or CD-RWs. Specifically, the Commission found that the Farla and Lokhoff patents were nonessential with respect to the Philips-only CD-RW and CD-R licenses, and that the Farla, Iwasaki, Yamamoto, and Lokhoff patents were nonessential with respect to the joint CD-RW license. The Commission concluded that the four nonessential patents were impermissibly tied to patents that were essential to manufacturing CD-Rs and CD-RWs, because "none of the so-called essential patents could be licensed individually for the manufacture of CD-RWs and CD-Rs apart from the package" that Philips denominated as "essential." The Commission also found, based on the administrative law judge's findings and analysis, that the joint license for CD-R and CD-RW technology unlawfully tied patents for CD-Rs and CD-RWs in accordance with the Orange Book standards to patents that were not essential to manufacture such discs.

The Commission explained why it concluded that each of the four patents was nonessential. According to the Commission, the Farla and Iwasaki patents were not essential because there was an economically ***1184** viable alternative method of writing information to discs that did not require the producer to practice those patents; the Yamamoto patent was not essential because there was a potential alternative method of creating master discs that did not require the producer to practice that patent; and the Lokhoff patent was not essential because there were alternative possible methods of accomplishing copy

protection that did not require the producer to practice that patent. Based on those findings, the Commission concluded that the four "nonessential" patents constituted separate products from the patents that were essential to the manufacture of the subject discs.

The Commission ruled that Philips's patent package licensing arrangement constituted per se patent misuse because Philips did not give prospective licensees the option of licensing individual patents (presumably for a lower fee) rather than licensing one or more of the patent packages as a whole. The Commission took no position on the administrative law judge's ruling that patent pooling arrangements between Philips and its colicensors constituted patent misuse per se based on the theories of price fixing and price discrimination, and it took no position on the administrative law judge's conclusion that the royalty structure of the patent pools was an unreasonable restraint of trade.

As an alternative ground, the Commission concluded that even if Philips's patent package licensing practice was not per se patent misuse, it constituted patent misuse under the rule of reason. Adopting the administrative law judge's findings, the Commission ruled that the anticompetitive effects of including nonessential patents in the packages of so-called essential patents outweighed the procompetitive effects of that practice. In particular, the Commission held that including such nonessential patents in the licensing packages could foreclose alternative technologies and injure competitors seeking to license such alternative technologies to parties who needed to obtain licenses to Philips's "essential" patents. The Commission took no position with respect to the portion of the administrative law judge's rule of reason analysis in which the administrative law judge concluded that the royalty rate structure of the patent pooling

arrangements constituted an unreasonable restraint on competition.

Philips took this appeal from the Commission's order.

II

[1][2] Patent misuse is an equitable defense to patent infringement. It "arose to restrain practices that did not in themselves violate any law, but that drew anticompetitive strength from the patent right, and thus were deemed to be contrary to public policy." *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700, 704 (Fed.Cir.1992). The purpose of the patent misuse defense "was to prevent a patentee from using the patent to obtain market benefit beyond that which inheres in the statutory patent right." *Id.* As the Supreme Court has explained, the doctrine of patent misuse bars a patentee from using the "patent's leverage" to "extend the monopoly of his patent to derive a benefit not attributable to the use of the patent's teachings," such as requiring a licensee to pay a royalty on products that do not use the teaching of the patent. *Zenith Radio Corp. v. Hazeltine Res., Inc.*, 395 U.S. 100, 135-36, 89 S.Ct. 1562, 23 L.Ed.2d 129 (1969). The "key inquiry is whether, by imposing conditions that derive their force from the patent, the patentee has impermissibly broadened the scope of the patent grant with anticompetitive effect." *C.R. Bard, Inc. v. M3 Sys., Inc.*, 157 F.3d 1340, 1372 (Fed.Cir.1998); ***1185** *Windsurfing Intl, Inc. v. AMF, Inc.*, 782 F.2d 995, 1001 (Fed.Cir.1986).

This court summarized the principles of patent misuse as applied to "tying" arrangements in *Virginia Panel Corp. v. MAC Panel Co.*, 133 F.3d 860, 868-69 (Fed.Cir.1997). The court there explained that because of the importance of anticompetitive effects in shaping the defense of patent misuse, the analysis of tying arrangements in the context of patent misuse is closely related to the analysis of

tying arrangements in antitrust law. The court further explained that, depending on the circumstances, tying arrangements can be viewed as per se patent misuse or can be analyzed under the rule of reason. *Id.* The court noted that certain specific practices have been identified as constituting per se patent misuse, "including so-called 'tying' arrangements in which a patentee conditions a license under the patent on the purchase of a separable, staple good, and arrangements in which a patentee effectively extends the term of its patent by requiring post-expiration royalties." *Id.* at 869 (citations omitted). If the particular licensing arrangement in question is not one of those specific practices that has been held to constitute per se misuse, it will be analyzed under the rule of reason. *Id.* We have held that under the rule of reason, a practice is impermissible only if its effect is to restrain competition in a relevant market. *Monsanto Co. v. McFarling*, 363 F.3d 1336, 1341 (Fed.Cir.2004); *Windsurfing Intl*, 782 F.2d at 1001-02.

[3] The Supreme Court's decisions analyzing tying arrangements under antitrust law principles are to the same effect. The Court has made clear that tying arrangements are deemed to be per se unlawful only if they constitute a "naked restrain[t] of trade with no purpose except stifling of competition" and "always or almost always tend to restrict competition and decrease output" in some substantial portion of a market. *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 19-20, 99 S.Ct. 1551, 60 L.Ed.2d 1 (1979). The Supreme Court has applied the per se rule only when "experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it ...." *Arizona v. Maricopa County Med. Soc'y*, 457 U.S. 332, 344, 102 S.Ct. 2466, 73 L.Ed.2d 48 (1982); *see Broad. Music*, 441 U.S. at 9-10, 99 S.Ct. 1551 ("It is only after considerable experience with certain business relationships that courts classify them as per se violations."),

quoting United States v. Topco Assocs., 405 U.S. 596, 607-08, 92 S.Ct. 1126, 31 L.Ed.2d 515 (1972); *Cont'l T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 49-50, 97 S.Ct. 2549, 53 L.Ed.2d 568 (1977) (per se rules are "appropriate only when they relate to conduct that is manifestly anticompetitive"); *see also* Jefferson Parish Hosp. Dist. v. Hyde, 466 U.S. 2, 14, 104 S.Ct. 1551, 80 L.Ed.2d 2 (1983) ("[T]he law draws a distinction between the exploitation of market power by merely enhancing the price of the tying product, on the one hand, and by attempting to impose restraints on competition in the market for a tied product, on the other."). Conduct is not considered per se anticompetitive if it has "redeeming competitive virtues and ... the search for those values is not almost sure to be in vain." *Broad. Music*, 441 U.S. at 13, 99 S.Ct. 1551; *Nat'l Collegiate Athletic Ass'n v. Bd. of Regents of the Univ. of Okla.*, 468 U.S. 85, 104 n. 26, 104 S.Ct. 2948, 82 L.Ed.2d 70 (1983) ("[W]hile the court has spoken of a 'per se' rule against tying arrangements, it has also recognized that tying may have procompetitive justifications that make it inappropriate to condemn without considerable market analysis.").

[4] While the doctrine of patent misuse closely tracks antitrust law principles in many respects, Congress has declared certain practices not to be patent misuse even ***1186** though those practices might otherwise be subject to scrutiny under antitrust law principles. In 35 U.S.C. 271(d) Congress designated several specific practices as not constituting patent misuse. The designated practices include "condition[ing] the license of any rights to the patent or the sale of the patented product on the acquisition of a license to rights in another patent or purchase of a separate product," unless, in view of the circumstances, the patent owner "has market power for the patent or patented product on which the license or sale is conditioned." *Id.* § 271(d)(5). Because the statute is phrased in the negative, it does not require that

patent misuse be found in the case of all such conditional licenses in which the patent owner has market power; instead, the statute simply excludes such conditional licenses in which the patent owner lacks market power from the category of arrangements that may be found to constitute patent misuse.

Although section 271(d)(5) does not define the scope of the defense of patent misuse, but merely provides a safe harbor against the charge of patent misuse for certain kinds of conduct by patentees, the statute makes clear that the defense of patent misuse differs from traditional antitrust law principles in an important respect, as applied to tying arrangements involving patent rights. In the case of an antitrust claim based on a tying arrangement involving patent rights, this court has held that ownership of a patent on the tying good is presumed to give the patentee monopoly power. *See Indep. Ink. Inc. v. Ill. Tool Works, Inc.*, 396 F.3d 1342, 1349 n. 7 (Fed.Cir.), cert. granted, --- U.S. ----, 125 S.Ct. 2937, 162 L.Ed.2d 865 (2005). Section 271(d)(5) makes clear, however, that such a presumption does not apply in the case of patent misuse. To establish the defense of patent misuse, the accused infringer must show that the patentee has power in the market for the tying product. *See Id.* at 1349 n. 7.

[5] Philips argues briefly that it lacks market power and that it is thus shielded from liability by section 271(d)(5). Based on detailed analysis by the administrative law judge, however, the Commission found that Philips has market power in the relevant market and that section 271(d)(5) is therefore inapplicable to this case. We sustain that ruling.

Philips contends that at the time Philips and Sony first created their package license arrangements, CDs had